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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 155

MAURICE J. BREEN and ALYCE J. BREEN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (Pet. A18-A23) is not officially reported. The opinion of the Court of Appeals (Pet. A1-A16) is reported at 328 F. 2d 58.

JURISDICTION

The judgment of the Court of Appeals (Pet. A17) was entered on February 26, 1964. The petition for a

writ of certiorari was filed on June 5, 1964, after entry of an order of April 30, 1964, by Mr. Justice White, extending until June 25, 1964, the time for filing the petition. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the personal services for which the taxpayer received a payment of $4,200 during the taxable year 1955 constitute an "employment" within the definition of Section 1301 of the 1954 Code, so as to entitle the taxpayer to the income-spreading benefits there provided.

2. Whether gains received by the taxpayer during 1955 and 1956 with respect to two "trustee's certificates" which he purchased in 1954 represented payments made to him as a creditor-claimant against the trust property and therefore taxable as ordinary income, or whether they represented payments in liquidation of an equity ownership in such property and therefore taxable as long term capital gains.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of the Internal Revenue Code of 1954, Sections 302, 317, 331, 652, 662 and 1301, and the Treasury Regulations on Income Tax (1954 Code) Section 1.1301-2, are set forth in the Appendix, *infra*.

STATEMENT

W. N. Merritt died in May, 1928. Among his assets at his death were undivided interests in two tracts of real estate near Des Moines, in Polk County, Iowa. These were heavily mortgaged. The taxpayer, a practicing lawyer, was named as executor and trustee in the decedent's will. (Pet. A2.)

The assets of Merritt's estate were insufficient to meet the claims of creditors. In September, 1930, a "Trust Agreement and Appointment of Attorney in Fact" was executed by the six major creditors, whose claims aggregated about $27,500, the will beneficiaries, and a bank as trustee. This agreement provided that (a) the six creditors released their claims against the estate; (b) the trustee assumed the title to the decedent's interests in the Polk County real estate and to certain stock not significant here; (c) the release of the claims was the purchase price for that property; (d) the trustee was authorized to convey the real estate interests so received to Urbandale Coal and Acreage Company,[1] a newly organized Iowa corporation, in exchange for half its stock; (e) the trustee was to hold that stock as trust property "and as security for notes evidencing the * * * indebtedness" to the creditors and to apply income of the trust in payment of interest and principal; (f) Urbandale was to receive, in exchange for the other half of its stock, equal undivided interests owned by attorney D. M. Kelleher in the same real estate; and (g) the

[1] Hereinafter referred to as Urbandale.

trustee was to hold the trust property until the indebtedness to creditors and the interest thereon were "paid in full, and thereafter hold the same for distribution to * * * the beneficiaries under the will of said W. N. Merritt in the proportions they are entitled to share in the Estate of said Testator". (Pet. A2-A3.)

The trustee issued a certificate to each of the six creditors. This recited that the creditor was the owner of a stated percentage "of the equitable ownership and beneficial interest in" the stock, including preferred and common of Urbandale, held by the trustee "for the benefit of the holder or holders of this certificate and all similar certificates issued"; that "when said interest and principal have been paid in full through the disbursements of said trustee, then this certificate shall have no more value"; and that the certificate "may be assigned and transferred". (Pet. A3.)

Almost 24 years later, in April, 1954, the taxpayer purchased for $2,500 one of the trustee's certificates representing a 46.66 per cent interest in the trust and an original creditor's claim of $12,932.92. A week later the taxpayer purchased for $150 a second certificate representing a 3.84 per cent interest and a creditor's claim of $1,050. (Pet. A3.)

Meanwhile, through a working mining company, Urbandale operated the coal mine on the Polk County land on a royalty basis until 1947. In December, 1952, the Merrit estate beneficiaries gave Urbandale a quitclaim deed to the land. (Pet. A3.)

During this entire period the taxpayer was president of Urbandale, Kelleher was vice-president, and

Mrs. Kelleher was secretary-treasurer. These three also comprised the directorship of the corporation during its corporate life. (Pet. A4.)

When the mining operations ceased, the taxpayer, as president of Urbandale, began to negotiate for the sale of the land, and sold it late in 1954. Urbandale then adopted a resolution to liquidate. In March, 1955, Urbandale's shareholders approved payment of a $4,200 fee to the taxpayer and of a like fee to Mrs. Kelleher. The authorizing resolution stated that, throughout its corporate existence of more than 24 years, no compensation had ever been paid to any officer or director (Pet. A4) and

> (1) That the said Maurice J. Breen and Mary S. Kelleher, each, be allowed the sum of $200.00 a year for their services as directors, and their services in attending board meetings and committee meetings, and other incidental work connected with the management of said corporation.
>
> (a) That said allowance extend over the first twenty-one years of the life of this corporation, as said twenty-one years covers the active operation of this corporation while it was engaged in the production of coal, and that said allowance to each of said named directors, to wit, Mary S. Kelleher and Maurice J. Breen, be in the sum of $4200.00 each.

The taxpayer's $4,200 fee was paid in 1955. Except for a $500 fee paid in December, 1949 for legal services on a special matter, the taxpayer had received no other compensation from Urbandale (Pet. A4.)

The trustee, from 1931 through 1956, made payments to the certificate holders. These were distributions from the coal royalties and upon the liquidation. The taxpayer received approximately $8,250 in 1955, and $13,350 in 1956, upon the two certificates he had purchased in 1954, and thereby realized gain. (Pet. A5.)

The taxpayer, on his return for 1955, reported the $4,200 fee under the income-spreading provisions of Section 1301 of the Internal Revenue Code of 1954, *infra*, and, on the 1955 and 1956 returns, reported as capital gain his gain on the respective distributions of $8,250 and $13,350. The Commissioner asserted deficiencies on several bases, including the disallowance of the spreading of the $4,200 and the capital gain treatment. Upon petition for redetermination, the Tax Court decided for the taxpayer upon several of the issues presented but sustained the Commissioner's ruling with respect to income spreading and capital gain treatment (Pet. A18-A23). The Eighth Circuit affirmed the Tax Court's disposition of these two issues.

ARGUMENT

1. The Court of Appeals correctly held that the $4,200 paid taxpayer in 1955 by Urbandale was intended as compensation for general managerial services rendered the corporation (Pet. A8-A9), and that such services did not constitute an "employment" within the meaning of Section 1301(b) of the Internal Revenue Code of 1954. Accordingly, the court properly denied him the income-spreading benefit provided in that section.

The taxpayer's initial argument (Pet. 18) is that the predecessor of Section 1301 (Section 107 of the 1939 Code) had been applied in other cases so as to authorize income spreading in connection with compensation for general managerial services to a corporation and that the new and more specific qualifying provisions of Section 1301 do not import a narrowing of coverage. But the fact is that, whereas Section 107(a) of the 1939 Code required only that the compensation be for "personal services", Section 1301(b) of the 1954 Code is much more limited and requires that it be received for "personal services * * * to effect a particular result". Accordingly, the Court of Appeals ruled (Pet. A11) that, whatever the 1939 Code provision may have meant, the clear language of the current provision does not embrace general corporate managerial services but requires that the income be received for services looking forward to the production of a particular, specific result. This construction is entirely consonant with the language of the statute, with the ruling of the Sixth Circuit in *Ranz* v. *Commissioner*, 273 F. 2d 810, and with applicable Treasury Regulations,[2] and there is no conflict of authority.[3]

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[2] Treasury Regulations on Income Tax (1954 Code), Section 1.1301-2(b)(1)(i), *infra*, provide that "an arrangement to perform general services is not an employment within the meaning of section 1301 either as to any particular project on which services are performed or as to the general services since there is no understanding that the services are to accomplish a particular result."

[3] *Wattley* v. *Commissioner*, 275 F. 2d 461 (C.A. 2d), cited by taxpayer (Pet. 18), does not constitute a contrary holding

The taxpayer also argues (Pet. 23-24) that, even if the 1954 Code bars his claim, it is covered by the more general terms of the 1939 Code because the services in question were, for the most part, performed during years prior to the effective date of the 1954 language, which (see Section 7851(a)(1)(A) of the 1954 Code) governs tax years beginning after December 31, 1953. But the appellate court correctly held (Pet. A7) that the case was ruled by the law in effect in 1955 (Pet. A4) when the income in question was received and not the law of earlier years during which it was earned. The taxpayer's reliance (Pet. 23-24) upon general statements that legislation altering substantive rights is not to be applied retroactively is misplaced since there was here no retroactive application. At issue was the taxpayer's liability for the year 1955—not the earlier years. Cf. *McClure* v. *United States*, 228 F. 2d 322, 324 (C.A. 4th); *Ranz* v. *Commissioner*, *supra* (where, also, most of the services were performed prior to the effective date of the 1954 Code).

Finally, the taxpayer contends (Pet. 18, 21-23) that his services to Urbandale were not of a general

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since (1) the court there had before it only tax years coming under the 1939 Code language, (2) the court's comment (p. 464) that Congress did not, in enacting Section 1301, appear to have intended to change the meaning of Section 107(a) was addressed to a question not here involved (whether a period of efforts as a representative of a corporation can be joined together with subsequent efforts as an individual in fixing the period of "personal services"), and (3) even this comment was merely a *dictum*, the court expressly refraining (p. 465) from deciding that question.

nature but were intended to accomplish a specific result—the liquidation of the company through the sale of the land. This is no more than a factual contention which the courts below rejected (Pet. A8-A9, A20-A21) on the basis of the record. The recitation by the Court of Appeals (Pet. A8-A9) reflects more than ample evidence to sustain the crucial finding and a factual question of this nature, significant only with respect to the case at bar, is not such as to warrant review by this Court.

2. With respect to the issue involving the tax treatment to be accorded the gains received by him during 1955 and 1956 arising out of the two "trustee's certificates" which he purchased in 1954, the taxpayer in effect asks this Court to determine whether certain instruments embodying conflicting terminology should more reasonably be construed as investing him with an ownership rather than with a creditor status.

Although the taxpayer invokes (Pet. 25, 26, 28, 36) certain sections of the Internal Revenue Code of 1954 (Sections 302, 331, 652 and 662, Appendix, *infra*), there is actually no disagreement as to the purport of those provisions. The cumulative effect of the above-cited sections of the Code, so far as here relevant, is (1) that a redemption of corporate stock shall be deemed an exchange between the redeeming corporation and the shareholders who surrender their stock to it and (2) that where amounts distributed to a beneficiary of a trust constituted capital gains

in the hands of the trustee, they shall be similarly treated in the hands of the beneficiaries.[4] But these provisions, by their terms, apply only where the income recipients were the legal or beneficial *owners* of the stock which was redeemed. Neither the Commissioner nor the courts below questioned that the amounts involved would qualify for capital gains treatment were this condition met, and the taxpayer has never denied the existence or the validity of the condition. Thus, the meaning of these sections of the Code has never been contested. The courts below denied the taxpayer's claim to capital gain treatment solely upon the holding (Pet. A13-A15, A21-A22) that he stood, really, in the position of creditor-claimant against the trust property, rather than that of a beneficial owner thereof. This controlling determination represented no more than a choice between conflicting contentions as to the intended relationship between the trust and the six creditors of the estate, as manifested by the language and actual provision of the several instruments. No question of law was involved and there was ample support (see Pet. A13-A15, A21-A22) for the courts' factual determination.

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[4] It should be noted that the latter provision is found in Sections 652 and 662 of the Code; the taxpayer did not, in the court below, cite these sections or rely upon this provision. It is doubtful, therefore, whether he may now ask this Court to consider them for the first time. See *Knetsch* v. *Commissioner*, 364 U.S. 361, 370. Section 652 is not, in any event, relevant since it does not deal with a distribution of corpus.

CONCLUSION

For the above reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY, 1964.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) *General Rule.*—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

* * * *

SEC. 317. OTHER DEFINITIONS.

* * * *

(b) *Redemption of Stock.*—For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired or held as treasury stock.

SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) *General Rule.*—

(1) *Complete liquidations.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

* * * *

SEC. 652. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Inclusion.*—Subject to subsection (b), the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. * * *

(b) *Character of Amounts.*—The amounts specified in subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the trust. * * *

* * * *

SEC. 662. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) *Inclusion.*—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

* * * *

(b) *Character of Amounts.*—The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. * * *

* * * *

SEC. 1301. COMPENSATION FROM AN EMPLOYMENT.

(a) *Limitation on Tax.*—If an individual or partnership—

(1) engages in an employment as defined in subsection (b); and

(2) the employment covers a period of 36 months or more (from the beginning to the completion of such employment); and

(3) the gross compensation from the employment received or accrued in the taxable year of the individual or partnership is not less than 80 percent of the total compensation from such employment,

then the tax attributable to any part of the compensation which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

(b) *Definition of an Employment.*—For purposes of this section, the term "an employment" means an arrangement or series of arrangements for the performance of personal services by an individual or partnership to effect a particular result, regardless of the number of sources from which compensation therefor is obtained.

* * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

Sec. 1.1301-2. *Compensation from an employment.*

* * * *

(b) *Definition of an employment.* (1)(i) The term "an employment" means an arrangement or series of arrangements for the performance of personal services by an individual or partnership to effect a particular result, regardless of the number of sources from which compensation for such services is obtained. Thus, there must be an arrangement, and the arrangement must be for the performance of a particular project. In other words, there must be an understanding for the performance of services to accomplish a particular result. Accordingly, an arrangement to perform general services is not an employment within the meaning of section 1301 either as to any particular project on which services are performed or as to the general services since there is no understanding that the services are to accomplish a particular result.

* * * *

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